THE ALABAMA PREPAID AFFORDABLE COLLEGE TUITION PROGRAM
MEETING OF THE BOARD OF DIRECTORS
February 23, 2011

M I N U T E S

Present:	**Absent:**
Treasurer Young Boozer, Chair	Ms. Gwen Appling
Senator Roger Bedford	Chancellor Freida Hill
Dr. Greg Fitch	
Representative Craig Ford	
Ms. Karen Gandy	
Mr. Marc Green	
General Paul Hankins, Vice Chair	
Dr. Richard Huckaby	
Ms. Patti Lambert	
Dr. William Meehan	
Mr. David Perry	
Mr. James Stubbs	
Mr. Mark Sullivan	

Others Present include:
Ms. Glenda Allred, Deputy Treasurer
Ms. Daria Story, Assistant Treasurer
Ms. Gina Smith, Assistant to Treasurer Boozer
Ms. Brenda Emfinger, College Savings Programs Director
Mr. Bud Pellecchia, Callan Associates
Mr. Dan Sherman, Buck Consultants
Mr. George Beck, Capell Howard
Mr. Chad Bryan, Capell Howard
Mr. Wade Sansbury, Mauldin & Jenkins

Agenda Item I.
Pursuant to written and public notice, the regularly scheduled meeting of the Board of Directors of the PACT Program was held in the Board Room of the RSA Headquarters on February 23, 2011.

Agenda Item II.
The meeting was called to order by Chairman Young Boozer at 1:05 p.m. Roll was taken with a quorum present. Chairman Boozer introduced new board members Karen Gandy, David Perry and Mark Sullivan, giving a summary of their credentials.

Agenda Item III.
Chairman Boozer presented the minutes of the December 1, 2010 board meeting. A motion was made by General Hankins, seconded by Mr. Stubbs for approval as presented. The motion was unanimously approved.

Chairman Boozer presented information and his observations to the Board on the status of the program. He stated that PACT was on a course toward total liquidation driven by a liability problem which will create a cash flow problem. He explained the change in funded status from June 2010 to December 2010. He provided graphs that depicted the sharp decline in Trust Fund assets with the Fund being projected to be depleted in 2015 and reaching the point in 2012 where funds would not be adequate to give full refunds to purchasers. He then detailed the cash flow and funding problems, stating that this would be constantly monitored and reported.

Agenda Item IV. (A.)
Chairman Boozer called on Ms. Emfinger for the program report. Ms. Emfinger called the board's attention to the increase in cancellations since the mailing related to the pending lawsuit. She also informed the board that annual statements and 1099's had been mailed.

Agenda Item IV. (B.)
Mr. Pellecchia from Callan gave the quarterly investment report. He began with an overview of the economy stating that there were concerns related to housing, unemployment and state and municipality budget issues. However, retail spending was up and corporate earnings were greater than expected.

Mr. Pellecchia stated that trust fund assets were $460,236,363 at the end of December with a quarterly return of 1.44% against the benchmark of 1.07%. Rhumbline, the indexed equity manager performed at the benchmark with a return of 11.59%. Principal, the international equity manager had a return of 9.38% against the benchmark of 7.2%. The two new fixed income managers, Longfellow and MacKay Shields did not have performance numbers for a full quarter and therefore, were not noted. Fixed income, in general, was negative for the quarter, but Mr. Pellecchia noted that the fixed income managers added value above the benchmark for the period they were invested.

Mr. Stubbs questioned the peer rankings for the fund. Mr. Pellecchia explained that most of the peers in the Callan database were public defined benefit plans having higher equity exposure in their asset allocations, which made it very difficult to have a meaningful comparison.

Mr. Pellecchia discussed CDO securities that were left from the Sterne Agee portfolio which were held in an effort to prevent taking a major loss. These securities were transferred to Longfellow, one of the new fixed income managers. He stated that Longfellow wanted permission to sell the securities when it was advantageous to do so. A motion was made by Representative Ford to allow Longfellow to sell the CDO securities when it was prudent to do so in an effort to minimize losses. The motion was seconded by Dr. Meehan with unanimous approval.

Mr. Pellecchia explained, for new board members, the role of the consultant in relationship to the PACT board. He explained that the consultant provides specific services and advice for a hard dollar fee. In this case, Callan does not have discretion over the assets, noting that the Board made the final decisions. He listed performance measurement for the fund managers, assistance with manager searches, and asset allocation studies as the major services they provide to the Board. He stated that Callan did not have a brokerage arrangement and received payment based on a flat fee of $120,000 per year for services.

Dr. Fitch questioned whether or not the board should consider a higher asset allocation to equities. Mr. Pellecchia explained that with the short time horizon for the assets to be held in the Trust, this would not be prudent. Even when there is a long-term time horizon, he explained that Callan believes in setting an allocation and maintaining it and that they were not proponents of trying to time the markets.

Dr. Huckaby stated that Callan had not given bad advice, nor had the board acted imprudently; rather, unexpected tuition increases had made it impossible for investment returns to keep pace.

Mr. Sherman, Buck Consultants, explained that from inception, there had been an assumed gap between the tuition increases and the investment return. The returns in most of the early years had been greater than tuition increases by more than the assumed gap, giving the fund a fully funded or over funded status. However, when the gap changed so that tuition increases were much greater than returns, the liabilities increased at a much higher rate than the assets, causing the huge fund shortfall.

Ms. Lambert asked whether or not something should have been done during 2008 when the markets continued to go down. Mr. Pellecchia explained the difficulty in that time period and the unprecedented decline that could not have been predicted, as well as the time and transaction costs associated with making dramatic asset allocation shifts for a fund of this size. General Hankins further explained that at the same time the markets were rapidly declining, tuition was rapidly increasing which created the liability problem.

Chairman Boozer informed the board that Callan's contract would be expiring in October 2011 and the Board would discuss options at the next meeting.

Agenda Item IV. (C.)
Chairman Boozer called on Mr. Sherman for the quarterly valuation report. Mr. Sherman discussed the December 30, 2010 valuation results, as compared to June 30, 2010. He stated that the increase in the unfunded liability resulted from the change in the calculation of the payment to private and out-of-state institutions. The funded status fell from 77.5% to 72.6%.

Mr. Sherman then discussed two additional scenarios requested by the Board. The first scenario provided the tuition cap on all institutions that would be needed to return to a fully funded status which was 3.5%. The second scenario changed the tuition assumption for regionals and two year colleges to 7.5% which would decrease the funded status from 72.6% to 68.4%.

Additional information was provided on the funded status if all beneficiaries were required to go to a two-year college for the first two years which would take the fund to a 96.6% funded status. Information was also provided on the specific projected loss of tuition to the Auburn University and University of Alabama systems if their tuition was capped at 3.5%

Mr. Sullivan asked Mr. Sherman for an analysis of the funding if the committed funds were received earlier than 2015. Mr. Sherman explained that given the short time horizon, the low interest rates and tuition/fee payments projected, there would not be a significant impact. Mr. Sherman discussed the cash flow analysis, noting that there would be a point where additional funds would be needed to fill the gap between the incoming funds and the needed benefit payments.

The Board discussed the need to find solutions to the unfunded liability. There was much discussion about the need to involve the University of Alabama and Auburn University systems in the solution. Chairman Boozer and Vice Chairman Hankins will plan to talk with the two systems. Additionally, Chairman Boozer agreed to meet with Vice Chairman Hankins, Representative Ford, Senator Bedford, Governor Bentley, Representative Hubbard, Senator Marsh, and Finance Director David Perry to discuss the PACT situation.

Agenda Item IV. (D.)
Mr. Wade Sansbury presented copies of the 2010 audit report. Mr. Sansbury reviewed the financial statements with the board, noting that it was a clean opinion with no findings. The report is attached for reference. A motion was made by Dr. Meehan and seconded by Mr. Stubbs to accept the report as presented. The motion was unanimously approved.

Agenda Item IV. (E.)
Mr. Beck was called on for a legal report. He stated that in the Perdue case, the board members were sued individually and a settlement had been reached. As a result, attorney fees had been paid and the remainder of the insurance funds, from Risk Management, approximately $520,000, had been deposited in the PACT Trust Fund. These funds will be available for legal fees unless the ruling is overturned in which case the funds go back to Risk Management.

He then discussed the Green case. He stated that the court had approved two classes. The classes include contracts purchased pre and post 2001, with a subclass for contracts purchased prior to 1996. He explained that the basic premise of the lawsuit was that purchasers entered into a contract with the Board and the State and that upon acceptance to a college or university, they should not have to pay for tuition and mandatory fees, according to the statute as it existed prior to 2001. He explained that the court was being asked to provide guidance in the event there was not enough money in the Trust Fund to pay benefits. He stated that depositions had been taken and discovery was ongoing.

He then discussed another issue in the case related to the payment of mandatory fees. He explained that the plaintiff was alleging that there were fees that PACT should pay that have not been paid and that this would also be detrimental to the fund. He stated that they were preparing for a hearing on the merits of the suit.

Agenda Item IV. (F.)
Chairman Boozer called on Ms. Emfinger for a report from the Petition Advisory Council. Ms. Emfinger informed the board that a petition had been received from a purchaser who stated that his beneficiary's university had refused to bill PACT because the child received an athletic scholarship that covered tuition and fees. He wanted PACT to pay him. Ms. Emfinger explained that legal counsel and the Council had denied the petition based on PACT program rules, procedures and other options available to the purchaser.

Agenda Item V. (A.)
Chairman Boozer called the board's attention to information on a June rule change involving the payment to private and out-of-state institutions. He explained that a decision had been made to exclude the Auburn University and University of Alabama systems from the calculation which resulted in no increase for 2011. The recommendation was to change the Rule back to the historical calculation which included all four-year public institutions, based on legal considerations. A motion was made by Mr. Stubbs for approval of the change. The motion was seconded by Ms. Lambert with unanimous approval. The rule will be effective immediately. The approved Rule is attached for reference.

Agenda Item V. (B.)

Chairman Boozer then provided information to the Board on the December approval of a Rule change regarding beneficiary substitutions. He explained that certain proposed language in the Rule contradicted the Board's primary intent. He offered revised wording to accomplish what the Board intended. A motion was made by General Hankins, seconded by Dr. Meehan for approval. With Ms. Lambert, Ms. Gandy and Dr. Huckaby voting no, the motion carried. The Rule, as approved, is attached for reference. Rules will be sent to the Legislative Council for approval.

Agenda Item VI.
Mr. Boozer provided a copy of the request for an Attorney General's Opinion to the board, stating that it had been submitted and a response was expected within a short period of time. He also provided a contact list for Board members.

Agenda Item VII.
Chairman Boozer then announced that the Board consider going into Executive Session for the purpose of discussing legal options and legal ramifications of pending litigation. Mr. Beck provided an oral declaration that the purpose of the session is warranted, and advised that no deliberations could be made during the session. Voice vote was recorded with every member consenting and a majority declared. The Board entered Executive Session at 3:00 p.m. Chairman Boozer stated that the session was expected to last approximately one hour and the board would reconvene in the open meeting.

Agenda Item VIII.
The Board reconvened at 4:00 p.m. Chairman Boozer stated that there had been no deliberation and there was no further business to discuss. The meeting was adjourned by motion.

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Brenda Emfinger, Recording Secretary

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Young Boozer, Chair